NATIONAL CREDIT UNION ADMINISTRATION

NCUA News

October 1997, Number 8

HIGHLIGHTS

Credit Union Growth Is Strong

"Growth is strong and consistent at the nation's federally insured credit unions," Chairman Norman E. D'Amours said checking results of the 1997 Mid-Year 5300 Call Reports. "Assets, loans, and shares continue to expand in a very competitive financial market. I think this reflects a thriving credit union system led by managers intent on fulfilling the true mission of credit unions, providing their members with quality, low-cost financial services."

NCUA's just released Mid-Year Financial Trends Report notes positive results during the first half of 1997, with the key financial indicators remaining strong and stable. Looking at the specifics for the first half of 1997 —

- Assets increased 5.6 percent, up from $326.9 to $345.2 billion
- Loans increased 3.9 percent, up from $213.8 to $222.2 billion
- Shares increased 5.6 percent, up from $286.7 to $302.8 billion
- Investments increased 9.2 percent, up from $98.3 to $107.4 billion
- Membership increased 1.9 percent to reach 70, 487,814
- Loan to share ratio declined from 74.6 to 73.4 percent
- Delinquent loans to total loans ratio remained 1 percent
- Capital to asset ratio remained 11.4 percent

Share accounts increased across the board. The most substantial growth reported during the first six months of 1997 was in share drafts, up $2.9 billion or 9.1 percent; money market shares, up $2.5 billion or 8.8 percent; share certificates up $5 billion or 7.6 percent, and regular shares moved up $4.4 billion or 3.6 percent.

While investments expanded at federally insured credit unions, lending slowed from the double-digit increase reported at yearend. During the first half of 1997, used auto loans continued to lead loan expansions. Of an $8.4 billion increase in lending, $3.7 billion or 10 percent was placed in used auto loans. Another continuously expanding market is 1st mortgage loans, up $3 billion or 6.5 percent; and other real estate loans, up 7.1 percent or $1.8 billion. Credit card lending leveled off to a small .3 percent gain, common in the first half of the year; while new auto loans, the largest category of credit union lending, experienced a small .4 percent increase. As loans continue to expand, delinquent loans remain a stable 1 percent of total loans.

Federal credit unions placed $9.1 billion in investments during the first six months of 1997. Almost half of that amount remained in the credit union system — $4.5 billion was invested with corporate credit unions, marking a 19.7 percent increase over December 1996 figures. Federal agency securities earned second place by expanding a substantial $3 billion, an 8 percent increase.

Credit unions added an additional $7.7 billion in liquidity during the first half of 1997, as share growth outpaced loan growth. As a result, the loan to share ratio declined slightly, from 74.6 percent at year end to 73.4 percent at June 30, 1997. Loan growth generally rebounds in the second half of the year and credit unions are well positioned to meet member's upcoming borrowing needs.

Confirmation Hearing Held

Dennis Dollar's confirmation hearing for a seat on the NCUA Board was held before the Senate Banking Committee on September 30. The full Senate must now vote on board seat nominations for both Mr. Dollar and Board Member Yolanda Wheat

***Expect an October Dividend** — With the NCUSIF equity level at 1.32 percent September 30, 1997, the NCUA is expected to return over $100 million to federally insured credit union at the end of October, marking the third consecutive dividend issued by the NCUA.*

News Briefs

Treasury Study Results Delayed — The Treasury Department's study of the National Credit Union Share Insurance Fund and corporate credit unions is not yet finalized. Study results, originally scheduled for Sept. 30, are now expected by mid-October.

H.R. 1151 — Currently 114 cosponsors have signed on to support HR 1151, the House Bill designed to clarify the long-standing NCUA policy that groups can form fields of membership at federal credit unions.

FFIEC Will Issue Draft Policy on Interest Rate Risk — In October, credit unions will be asked to respond directly to the FFIEC on a draft policy statement concerning interest rate risk. Among issues being considered are the high risk security test on CMOs/REMICs and expanding the evaluation of other investment instruments. If the NCUA Board adopts the policy, changes would be issued as an Interpretive Ruling and Policy Statement.

Upcoming *Letter to Credit Unions* — In lieu of a regulation, NCUA is drafting a *Letter to Credit Unions* that will address medical savings accounts

Credit Union Failures Remain Low — Nine credit unions had failed through August 31, 1997, at a cost of $1.2 million. Five were involuntary liquidations and four merged with assistance.

Electronic Expert Being Added — NCUA is adding an Information Systems Officer to provide the agency with expertise and coordination on information technology systems and cyber-financial examinations within the credit union industry.

Upcoming Board Votes

The NCUA Board is expected to schedule a vote on the following items by yearend:

- NCUSIF Dividend to Federally insured credit unions
- Final CUSO Rule, Section 701.27;
- Proposed Fixed Asset Rule, Section 701.36;
- Final Touhy Regulation, Part 792, Subpart C; and
- Final Member Business Loan Rule, Part 723 and Part 722

NCUA News

NCUA News is published by the National Credit Union Administration, the federal agency which supervises and insures credit unions.

Norman D'Amours, *Chairman*
Shirlee P. Bowné, *Vice Chairman*
Yolanda T. Wheat, *Board Member*

Information about NCUA and its services may be secured by writing to the Office of Public and Congressional Affairs, or by calling 703-518-6300. News of what is happening at NCUA is available by calling 800-755-1030 or 703-518-6339.

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GC Opinion Letters

The NCUA Office of General Counsel responds to written requests for legal interpretations of the *Federal Credit Union Act and NCUA Rules and Regulations.* Summaries follow of some of the latest letters issued that may interest the credit union community. These legal opinions can be secured by writing to the Office of Public and Congressional Affairs, 1775 Duke Street, Alex., VA 22314-3428. Please provide the identifying number and title when making a request. General Counsel opinion letters are also available electronically on the NCUA web site at http://www.ncua.gov.

No. 96-1202 *Phone Cards* — An FCU may sell prepaid phone cards, as part of a group purchasing activity, but may not earn a profit or a commission from the sale. July 23, 1997

No. 97-0407 *Business Loans —Associated Members* — The aggregate amount of outstanding business loans to any one member or group of associated members must not exceed 15 percent of a credit union's reserves (less allowance for loan losses) or $75,000, whichever is higher. As defined in the rule, "associated members" have a "shared ownership, investment, or other pecuniary interest in a business or commercial endeavor with the borrower." Sept. 8, 1997

No. 97-0508 *Impermissible Loans - Overdrafts* — An FCU may voluntarily pay or honor a share draft on an overdrawn account only when an overdraft lending agreement exists between the FCU and the member. Otherwise, the FCU would be making an impermissible loan. July 7, 1997

No. 97-0539 *Revocable Living Trusts* — Living trusts are governed by state law not the *Federal Credit Union Act* and federal credit unions have limited trust authority and no authority to interpret trusts. Beneficiary information explaining the degree of kinship to the member is crucial for a FCU to clarify insurance coverage provided on revocable trusts, tentative or Totten trust accounts, payable-on-death account, and other testamentary accounts. July 3, 1997

No. 97-0540 *Insurance Coverage of Member Accounts* — This letter explains the insurance coverage provided by the National Credit Union Share Insurance Fund on individual and joint accounts. August 12, 1997

No. 97-0541 *Mechanical Breakdown Services* — If state law classifies a mechanical breakdown service agreement as insurance and an FCU sells the agreement in conjunction with financing a vehicle covered by the agreement, the FCU can receive compensation and pay an employee incentive bonus. August 18, 1997

No. 97-0705 *Business Share Draft Account Dividends* — The *Federal Credit Union Act* authorizes paying dividends on members' share draft accounts. The restriction against paying dividends noted in Section 205(f)(2) applies to organizations that legally establish share draft accounts but are not members of the credit union. August 12, 1997

Correction

The August issue of the NCUA News was the Number 7 issue for 1997.

BOARD MEETING ACTIVITY

FOM Policy Action Delayed

The NCUA Board voted to temporarily table the Field of Membership Policy action scheduled at the September meeting.

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Outdated, Unnecessary IRPS Eliminated

The NCUA Board voted to withdraw 28 Interpretative Ruling and Policy Statements (IRPS). Eighteen are outdated or irrelevant because they are incorporated elsewhere in regulations or manuals and ten have been superseded by other IRPS or NCUA regulations.

After seeking comments earlier this year and thoroughly reviewing NCUA's IRPS, the agency is taking its first step to update and streamline its IRPS and to ease the compliance burden imposed on federally chartered and insured credit unions.

The nine IRPS recommended for redesignation into the NCUA R&Rs in the March 13, 1997, proposal will be redrafted as proposed rules. IRPS that remain will undergo additional reviews. If changes are necessary, these IRPS will be reissued. A list of the IRPS being withdrawn can be found in the Reference Section on NCUA's WWWeb site at www.ncua.gov.

CLF Loan Security Regulation Proposed

The NCUA Board issued a proposal to modify the regulation pertaining to the security interest that the CLF requires on loans. Current regulations require the CLF to secure each loan with a blanket lien on all assets of the borrowing credit union.

To give credit unions greater flexibility and to accommodate credit arrangements with multiple parties, the proposed amendment would permit the CLF to take a first priority security interest on specific assets of the credit union with a net book value at least equal to 110% of the amount borrowed instead of the presently required blanket lien. The comment period is 60 days after publication in the *Federal Register*.

Chartering Activity

New Charter Granted — The NCUA Board granted a community charter to Comunidades FCU to serve residents in southwest Los Angeles. The new credit union will serve the 2.5 square mile community of Pico Union, a low-income, primarily Hispanic neighborhood of 70,000 people with little access to affordable financial services.

Local and regional economic development corporations, private foundations, other credit unions, and community based organizations support the new charter.

Conversion to Federal Charter — The NCUA Board approved $47 million Twin Harbors Credit Union's request to convert to a federally-chartered, federally insured community credit union. The Aberdeen, Washington, credit union serves the 83,000 low-income residents of adjoining Pacific and Grays Harbor Counties.

FOM Conversions — Bay FCU, Capitola, Calif., gained authority to convert from a multiple-group to a community-based charter that will serve the 231,000 residents of Santa Cruz County. A random telephone survey of residents yielded an 87 percent approval rating, 20 letters of support were received, and 2,171 credit union members signed a petition expressing their desire to have the credit union serve the community. The $113 million institution was chartered in 1957.

Yolo FCU, a $54 million Woodland, Calif., credit union, received Board approval to convert from a multiple-group charter to a community charter serving the 141,100 residents of Yolo County. The credit union sought a charter conversion to serve the entire county, including the 13 small towns now without financial services. The FCU has a 72.7 percent penetration rate among its current 18,000 potential members.

Navmar FCU, Agana, Guam, gained authorization to convert from a multiple-group membership to be the first community-based credit union chartered to serve the 140,635 residents of Guam. By expanding, the $37 million credit union will be able to offer island residents an alternative to otherwise often expensive financial services. The expansion will also help stabilize current downsizing of its core military membership base. The credit union has wide support to expand its field of membership, including a wait-list of people who, up to this point, have been ineligible to join.

Mid-Florida FCU, a $249 million credit union in Lakeland, Fla., gained authority to convert from an occupational to a community-based charter that will serve the 452,000 people who live, work, worship, or attend school in Polk County and low-income Highlands County. Mid-Florida FCU received 167 letters from civic and political leaders and businesses supporting the conversion.

Linn-Co FCU, a $29 million credit union in Lebanon, Oregon, received authority to convert from a multiple-group to a community-based charter serving the 91,000 residents of Linn County. With no community credit union available to serve county residents and many of the area's major banks downsizing or leaving the rural areas, the credit union plans to focus on providing financial services to all county residents. Business and civic leaders and current and potential credit union members have expressed support for the conversion.

O.S.U. FCU, Corvallis, Oregon, became the second community-based credit union able to serve the residents of Linn County as it gained authority to convert from a multiple-group to a community charter. In addition, $173 million O.S.U. FCU also expanded to serve all residents of Benton County, Oregon. Ninety-two percent of the adjoining counties' 162,000 residents live within a 30-mile radius known as Mid-Willamette Valley. O.S.U. FCU has support from education, community, and business leaders and a survey found a majority of area residents favor adding more credit union service in their community.

A.E.A. FCU, a $128 million credit union in Yuma, Ariz., gained authority to convert to a community-based credit union that will serve the 138,500 residents of Yuma County and adjoining, low-income, La Paz County, Arizona. Area citizens, businesses, and organizations expressed support for the conversion. The credit union received 618 letters and 3,300 people responded positively to a survey of community and rural district residents.

Year 2000: Where Should I Be?

The answer to this question is not as easy as you might think. As discussed in NCUA Letters to Federally Insured Credit Unions #96-CU-5 and #97-CU-6, there are five major phases for addressing the Year 2000 problem:

1. Awareness;
2. Assessment;
3. Renovation;
4. Validation and Testing; and
5. Implementation.

By this time, all credit unions should have completed Phase 1 for all their systems. If a credit union is not beyond Phase 1, most likely they will not have sufficient time to convert their non-compliant systems to compliant systems. Phase 1 involves:

- defining and explaining the importance of achieving Year 2000 compliance;
- selecting an overall approach for structuring the institution's Year 2000 program;
- assessing the adequacy of the existing information resource management infrastructures to support the Year 2000 effort; and
- mobilizing resources, including the establishment of a Year 2000 committee.

Depending on the size and complexity of the credit union, the number and type of systems in place, and the number of personnel assigned to the Year 2000 project, a credit union could be in any one, or all, of the phases with the exception of Phase 1.

Sound business practice indicates that credit unions should have renovated systems in place by December 31, 1998 (to allow for testing and implementation during 1999). Industry experts believe that testing will consume at least 50% of the time it will take to fully address the Year 2000 problem. There are only 16 months left to complete Phases 1 through 3.

Phase 2 should also be completed for all critical systems and most of Phase 2 for non-critical systems. Phase 2 involves:

- inventorying application and platform systems;
- determining which systems are critical and which are non-critical;
- ranking the systems by assessing the impact of a system's failures on the credit union's operations and processes;
- determining which systems the credit union will renovate, replace, or retire; and
- determining if the credit union has the resources available to address the problem.

Whether a system is critical or non-critical should determine where a particular system is in the conversion process. In most cases credit unions should have various systems in various stages of completion — this process is called "overlap project management". Ideally, the higher ranked critical systems should be further along in the conversion process than the lower ranked critical systems, and the lower ranked critical systems further along than the higher ranked non-critical systems, etc.

The following sample table demonstrates an overall conversion timeline using overlap project management:

	Critical Systems		Non-Critical Systems	
	Start	**Complete**	**Start**	**Complete**
Awareness	5/97	6/97	5/97	6/97
Assessment	6/97	9/97	6/97	10/97
Renovation	7/97	9/98	10/97	10/98
Testing	8/97	9/99	6/98	9/99
Implementation	9/99	12/99	9/99	12/99

Obviously, this table only provides limited insight and guidance for addressing the Year 2000 problem. To ensure adequate management of the conversion project, credit unions should establish a timeline for each system they must convert and ensure that its timeline fits within their own overall conversion timeline.

So, what is the answer to the original question? For all systems, credit unions should have completed, or will complete soon, Phases 1 and 2. Critical systems should already be in Phases 3 and 4, depending on their priority ranking.

What if you need more time for critical systems?

Unfortunately, additional time is not an option (Year 2000 will arrive on time).

Incidentally, if vendors tell you that they are already Year 2000 compliant, do not accept that as fact without thorough testing. Most vendors are working toward becoming compliant, but few are actually there.

CHARTERING ACTIVITY

S&Ls in Wisconsin and Pennsylvania Seek CU Charters

The National Credit Union Administration has approved federal share insurance for two thrifts. The NCUA Board Sept. 17 granted insurance coverage to $90 million-asset Employes' Mutual Saving Building & Loan Association, in Milwaukee, Wisc., which cleared the way for the thrift's account holders to vote on a proposed conversion to a state-chartered credit union.

The $2 million-asset Trident Savings and Loan, in Philadelphia, Penn., converted to **Trident Credit Union**, a state-chartered credit union, Sept. 2, after receiving federal insurance coverage August 29. Trident CU is sponsored by the Ukrainian National Choir, and has a potential membership of 739 persons.

Chartered in 1914, Employes' Mutual Saving Building & Loan Association serves employees and retirees of Wisconsin Electric Power Company and Wisconsin Energy Corp., and their immediate family. If the conversion is approved, the name of the credit union will be **EMSBLA Credit Union**, and employees of Wisconsin Energy Corp.'s subsidiaries will also be eligible for membership. Current account holders total approximately 5,000, while the potential membership upon conversion will be more than 7,500.

A total of three S&Ls have now converted to credit union charters. The first was $1.2 billion-asset Eastman Savings & Loan Association, Rochester, N.Y. It converted to ESL Federal Credit Union in February 1996, and continues to serve employees and retirees of the Eastman Kodak Company and their immediate family.

OASIS Charter Serves R.I. Community

The National Credit Union Administration has granted a federal credit union charter to OASIS Community Development Federal Credit Union to serve some of Providence, Rhode Island's, poorest neighborhoods.

The 37,000 persons who live, work, or worship in Elmwood, Washington Park, West End, Upper South Providence, and Lower South Providence sections of the city will be eligible to join the new credit union.

Because OASIS Community Development FCU was also granted a low-income designation, it can accept a limited amount of nonmember deposits from businesses, foundations, and other financial institutions. It also qualifies to apply for low-interest loans and technical assistance through the NCUA's Community Development Revolving Loan Program.

OASIS Community is the seventh federal credit union chartered by the NCUA in 1997. Of the seven new credit unions, six were chartered to serve majority low-income neighborhoods.

HMDA—CRA Notification

FFIEC Adds Geocoding Web Page

The Federal Financial Institutions Examination Council (FFIEC) has added a Geocoding Web page — http://www.FFIEC.gov — to provide additional information and improve the quality of HMDA and CRA data reported.

The web page allows users to enter a street address and retrieve the associated MSA, state, county, and census tract/BNA information. It also provides helpful census demographic information about the median income percentage, income dollar levels, total population, minority population, and the number of housing units for the tract/NBA selected.

Information can be retrieved and printed for each valid street address entered. This application provides up-to-date street address coverage for the entire country.

Year 2000 Compliant HMDA/CRA Software

The FFIEC will have HMDA/CRA data entry software available beginning in December 1997 (for 1997 and 1998 data) that will be Year 2000 compliant according to an FFIEC letter dated June 24, 1997. The explanatory correspondence can be found on the FFIEC web site at http://www.ffiec.gov/hmda/y2k.htm. Questions can be directed to the FFIEC assistance lines — HMDA (202) 452-2016 and CRA (202) 872-7584.

CUs Find New 5300 Report a Breeze

Federally insured credit unions reported a smooth transition to the new *5300 Call Report* NCUA introduced during the June 1997 data collection cycle. The new design relieved many credit unions of the need to complete some previously required schedules. At the same time, more and more credit union filers are finding PC 5300 Windows an efficient reporting method.

As preparers' learned, the new report contains five core pages that all credit unions are required to complete and seven supplementary schedules. Credit unions that engage in a broader range of investment, share, or lending activities must complete the supplementary schedules as needed.

Several credit unions commenting on this cycle's changes said that the modifications were not significant and were easy to adapt. Kim Kroll of Southbridge CU said, "Completing the report was simple. There really wasn't much change" and "the changes were consistent with the prior version."

While adjusting to the new format was easy, it also reduced the reporting burden for many institutions. For example, 30 percent of all filers did not have to complete Schedule - C Investments, which includes more than half of all credit unions under $5 million in assets. Previously, all credit unions had to complete the investment schedule.

The new form is available in both Windows and DOS software. While PC 5300 Windows software is a fact of life for many, it has only been available to all credit unions for the last three semiannual reporting periods. In just 12 months, its use has increased 37 percent. Now, almost half of all filers use PC 5300 Windows and many are pleased with the software. Fran Kelley of St. Dominics Credit Union, who recently upgraded to Windows commented, "The PC 5300 Windows installation was very easy and the program is fast."

NCUA only provides the tools. Credit unions have made the midyear reporting cycle a success and we thank you for adaptability and conscientious reporting.

ABOUT INVESTMENTS

Defining Investment Responsibilities by Office of Investment Services Staff

Boards of Directors have fiduciary responsibility for the activities of their credit unions. NCUA Rule Part 703, which becomes effective January 1, 1998, helps define, not create, investment responsibility for each credit union's board of directors. Although Board members are not expected to understand all the details of each investment transaction, they need to understand and manage the risks in the portfolio.

To meet its responsibilities, the board must approve a detailed investment policy, set overall risk guidelines, and review both annually. The board is also responsible for ensuring the person given investment authority is "professionally qualified" to exercise that authority in a prudent manner. The person should understand and assess the risk characteristics of the investments the board authorizes in its policies. This person's level of expertise should be commensurate with the complexity of the investments permitted by the investment policy.

The board must oversee the activity in the portfolio and review reports designed to communicate risk to ensure investments and transactions comply with the board's policy and Part 703. The board must receive monthly reports that include data for each security in the portfolio. Additional quarterly reports are required if investments have features specified in Part 703. The reports must be accurate, disclose the risks in the portfolio, and document that risk falls within the guidelines established in the investment and/or ALM policy. For more details on the reports and reporting requirements, look to Part 703.

The board's function is to safeguard the assets of the credit union. Part 703 helps define the safety and soundness criteria for boards of directors.

http://www.ncua.gov

NCUA's Publications List and the accompanying order form to e-mail or fax are available under Reference Information on NCUA's Web site. Many publications, including NCUA NEWS, are available to download.

September 5, 1997 — Norman Murphy, President of the Irish Credit Union League and Michael Smith, Ireland's Minister of Science, Technology & Commerce meet with Chairman Norman E. D'Amours at the minister's office in Dublin. Chairman D'Amours visited the regulator, officials, and credit unions during his 5-day tour in Ireland.

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